

# **CHAPTER 3**

## **REAL PROPERTY CAPITALIZATION**

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## CHAPTER 3 – REAL PROPERTY CAPITALIZATION

3-1. **PURPOSE.** This chapter provides guidance for the proper identification and accounting treatment of real property. Real property includes land, buildings, other structures, and easements. Real property is recorded in the FA module and in REMS. The FA module is the system of record that is audited as part of the Financial Statement Audit process. REMS will receive daily updates of real property acquisitions and other information from the FA module.<sup>1</sup>

### 3-2. LAND AND LAND RIGHTS.

<b>General Ledger Account 17116000 - Land &amp; Land Rights –Unclassified</b>
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a. This asset account includes all government-owned land or interest in land (ownership in fee simple or ownership of easements<sup>2</sup>) under FAA control. The value of the asset comprises all costs incurred to acquire the land, including:

- Contract purchase price of the land, any external legal fees for activities such as title search costs or closing costs (services not performed by FAA employees).
- Title insurance costs.
- Condemnation costs (including settlement costs).
- Plots, survey and appraisal fees costs incurred due to an Environmental Due-Diligence Audit (EDDA).
- Removal of structures or facilities purchased but not used (less credit for salvaged materiel).

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<sup>1</sup> Refer to Appendix A “Financial Accounting Treatment of Typical FAA Costs Incurred in the Acquisition of Fixed Assets,” for a comprehensive list of costs eligible for capitalization.

<sup>2</sup> An easement provides limited land rights, which may or may not have monetary value. In addition, the term of an easement may be indefinite or it may have a stated term.

b. **Unit of Capitalization.** All land and land rights will be recorded in the FA module and REMS, to establish control and accountability over such items. In addition, the costs of all land or land rights (easements) are capitalized on the financial records of the FAA, regardless of whether these costs meet the \$25,000 capitalization threshold.

**Example:** *FAA incurred the following costs to acquire land lot #1:*

<i>Land</i>	<i>\$10,000</i>
<i>Title fees</i>	<i>\$ 5,000</i>
<i>Appraisal fees</i>	<i><u>\$ 7,500</u></i>
<i>Total Costs</i>	<i>\$22,500</i>

*The FA module will post GL account # 17116000, "Land & Land Rights," in the amount of \$22,500.*

*Land will be recorded in the FA module and REMS.*

c. **Depreciation.**

1. Land is a unique asset that is not subject to depreciation because it has an unlimited life.

2. Generally, land rights or easements, are also structured to have an indefinite life and would therefore be ineligible for depreciation or amortization. However, if an easement has a limited term and has a cost basis greater than \$25,000, then its cost basis would be amortized over the term of the land right.

### 3-3. **BUILDINGS.**

<p><b>General Ledger Account 17306000 - Buildings, Improvements, and Renovations</b></p>
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a. This asset account includes FAA-owned buildings. It also includes capital improvements incurred after the date of acquisition. All costs incurred to construct the building and to prepare it for its intended

use are eligible for capitalization. Examples of these types of costs include:

- Design and engineering.
- Fixtures and equipment that are normally required for functional use of the building; either built into the structure or otherwise permanently affixed, when the removal of these fixtures would materially damage the building, such as heating and lighting fixtures, elevators, air conditioning systems, partitions, and plumbing.
- Fixtures and equipment installed outside the building, that support one of the systems necessary for the primary function of that building only, such as fuel tanks (both above and below ground) for heating systems, compressors for air conditioning systems, and water tanks.
- Any addition, annex, lean-to, attached shed, garage, underground room, or modification that becomes an integral part of a building after original construction or acquisition, such as an underground equipment room for a tower, a lean-to attached to a hangar.
- Built-in storage bins, safes, vaults, or cabinets, etc., such as kitchen cabinets in living quarters.
- Initial site preparation, including clearing, grading and drainage, and landscaping.

b. Unit of Capitalization. The decision as to whether building costs are capitalized or expensed is made at the asset level, and includes all costs incurred for the construction of a building, rather than at an individual invoice or charge level, or an individual project/task. The building costs are capitalized (as discussed above) if the total of these costs for all associated projects/tasks meet or exceed \$25,000, and the building has an expected service life of two years or greater. Each building is treated as a separate asset record for capitalization and property management considerations.

**Example 1:** *The FAA incurred the following costs for the construction of a building:*

<i>Project 1202CE4435</i>	
<i>Building Construction contract</i>	<i>\$280,000</i>
<i>Labor</i>	<i>\$100,000</i>
<i>Fixtures</i>	<i><u>\$ 55,000</u></i>
<i>Total project 1202CE4435</i>	<i>\$435,000</i>
<i>Project 1203CE5882</i>	
<i>Labor</i>	<i>\$ 15,000</i>
<i>Built-in cabinets</i>	<i><u>\$ 5,000</u></i>
<i>Total project 1203CE5882</i>	<i>\$ 20,000</i>
 <i>Total Cost for Building</i>	 <i>\$455,000</i>

*The total building cost of \$455,000 exceeds the \$25,000 capitalization threshold. Although one of the projects did not exceed the capitalization threshold, the total project (including both projects) does meet the criteria. Therefore, the building will be capitalized and recorded in the FA module at the full cost of the asset:*

*The FA module will post GL Account # 17306000, "Buildings, Improvements, and Renovations," in the amount of \$455,000*

*The building will also be recorded in REMS.*

**Example 2:** *The FAA incurred the following costs for the construction of a shed:*

<i>Materiels</i>	<i>\$15,000</i>
<i>Labor</i>	<i><u>\$ 4,000</u></i>
<i>Total Costs</i>	<i>\$19,000</i>

*Since the total cost of the shed does not meet the \$25,000 capitalization threshold, they will be expensed.*

*The FA module will post GL Account # 61003600, "Operating Expense," in the amount of \$19,000.*

*Even though the shed does not meet the capitalization criteria, it will be recorded in REMS as an accountable real property asset.*

**Example 3:** *The FAA establishes one project to construct 2 small buildings at a site. Costs for this project total \$47,000, divided as follows:*

<i>Building A</i>	<i>\$35,000</i>
<i>Building B</i>	<i><u>\$12,000</u></i>
<i>Total project</i>	<i>\$47,000</i>

*The cost for Building A exceeds the capitalization threshold, so should be capitalized. However, the cost of Building B should be expensed, as it does not exceed the \$25,000 threshold:*

*The FA module will post to the following:*

*GL Account # 17306000, "Buildings, Improvements and Renovations" \$35,000*

*GL Account # 61003600, "Operating Expense" \$12,000*

*Both assets will be recorded in REMS, one as a capital asset and the other as an accountable asset.*

### **3-4. IMPROVEMENTS, REPAIRS, AND MAINTENANCE.**

a. Improvements either extend the useful life of existing in-use fixed assets by two years or greater or enlarge or improve their capacity. Improved capacity also includes improved asset performance. Improvements are typically made to buildings, but may also apply to other classes of in-use fixed assets. If the total cost of the improvement meets or exceeds \$25,000, then it is considered a capital improvement. If the parent asset is fully depreciated, the capital improvement will be depreciated over a period of 10 years for real property and 3 years for personal property.

1. Typical improvements occurring in the FAA include building roof upgrades (other than a mere shingle replacement), replacement of HVAC chiller systems, or repaving parking lots. Improvements are distinct from both repairs and maintenance, which should not be capitalized (see paragraphs 3-4.b and 3-4.c for definitions).

2. Evaluate an improvement for capitalization separately from the original asset that it improves. Neither the original cost of the asset nor the designation of the FAA appropriation (F&E or OPS) influence the capitalization determination (see paragraph 2-4 on page

2-5). A capitalizable improvement is recorded as a separate new “child” asset, linking the improvement to a “parent” (original) capital asset record in both the FA module and in REMS or PPIMS.

**Example 1. Expense:** *The FAA incurred the following costs for a new roof on a building with 20 years remaining out of a 40-year useful life.*

*Cost incurred for the replacement of existing roof = \$48,000. The total costs meet the capitalization dollar threshold; however, these costs would be expensed as they do not extend the life expectancy of the asset, nor do they enlarge or improve the asset. Since the new roof did not extend the useful life of the basic building (the new roof was installed in year 20), it would not be capitalized if the building still was expected to have the same original estimated service life of 40 years.*

**Example 2. Capitalization:** *The FAA spends \$600,000 to increase the square footage of a building that originally cost \$1,000,000 with a 40 year life. The improvement is made at the 10<sup>th</sup> year of operation.*

*Costs incurred for the improvement in year 11 of useful life = \$600,000. In this example, the asset was enlarged so it is considered an improvement. Depreciate the improvement over the remaining 30 years. Annual depreciation would be \$20,000 per year ( $\$600,000 / 30$  years).*

*In addition, new costs capitalized (or expensed) in prior years do not affect the capitalization decision. Nor does the original cost of the building have a bearing on the capitalization decision.*

b. Property repairs are generally defined actions that either fix inoperable property or correct damage to property so as to bring it to, as near as possible, its original condition and efficiency without upgrade to, improvement of, or change in the form of the property. These costs are not capitalized, but are normal yearly operating expenses.

c. Property maintenance is generally defined as the upkeep of a property to maintain it in its original condition to perform efficiently the service for which it is used, without upgrade to, improvement of, or change in the form of the property and which does not extend the useful life of the property. These costs are not capitalized, but are normal yearly operating expenses.

### 3-5. LAND IMPROVEMENTS.

**General Ledger Account 17126000 - Improvements to Land,  
(usually vacant land)  
(This is a new GL account that has been set up within the FA software**

a. As a result of this new DELPHI general ledger account, certain assets previously recorded as “other structures” will now be recorded as improvements to land. The use of this account will begin prospectively with the implementation of the FA module. There will be no mass transfer of records from Other Structures to Land Improvements.

b. Assets that should now be recorded as land improvements include:

1. Ditching, drainage, and pipes that make up drainage systems on vacant land.

2. Landscaping, including clearing, grading, excavating, and filling on vacant land.

3. More to be determined as experience is gained with this new account.

c. The assets recorded in the Improvements to Land account are subject to depreciation.

### 3-6. OTHER STRUCTURES.

**General Ledger Account 17406000 - Other Structures & Facilities.**

a. This asset account includes any FAA-owned structures (other than buildings) that possess characteristics of physical or operational permanence, are permanently affixed or attached to land or a building by

foundation or otherwise, and that at the time of construction are not designed to be dismantled and moved for use elsewhere. Examples include:

- Airfield structures - including taxiway pavements, aprons, warm-up pads, turnoffs, bypasses, dams, concrete ditching and pipes that make up the drainage system serving an airfield up to where the system discharges into another system, open water or ground.
- Airport runway, threshold, and taxiway lighting systems - including installed fittings, fixtures, conduit, transformers, regulators, cable, wire, etc., up to where power and control cables enter a building.
- Roads or road components - including pavement, concrete ditching, culverts, bridges, guard rails, signs, or signals, etc.
- Visual landing aid systems - including installed lamps, steel supports, fittings, fixtures, conduits, transformers, junction boxes, substations, cable wire, etc., up to where power and control cables enter a building.
- Antenna components - including towers, poles, counterpoises, supports, insulators, wire, and waveguide lead-in cables (up to where waveguide cable or wiring enters a building).
- Fuel and water distribution components serving more than one building or activity - including storage tanks, pipes, valves, reservoirs, etc., up to where the service enters a building (if such a system serves only one building, then it would be capitalized as part of the cost of that building, rather than separately as an other structure or system).
- Fire protection systems, serving more than one building, including storage tanks, pipelines, pumps, valves, fittings, hydrants, alarm systems, etc., up to where the service exits from or enters a building.
- Power generation or distribution systems serving a building or structure, including poles, towers, cables, wire, transformers, protective devices, insulators, etc., but excluding engine generators and uninterruptible power systems, regardless of size,

which are considered installed facility equipment, up to where the service exits or enters a building.

- Sewage disposal components - including drains, pipelines, treatment tanks, outfalls, etc. from a building outward.
- Communications systems - including cable, lines, poles, towers, fittings, insulators, etc., up to where lines or cable exit or enter a building, or are connected to a commercial service.
- Communications structures installed on land - including towers, cable, and wire, up to where the wiring or cable enters a building.
- Tramways, marine railways, piers and wharves - including electrical and mechanical devices, such as cranes, winches, motor capstans, etc., used in their operation. Small structures attached to wharves, piers, tramway etc., primarily housing (that is not a building) associated operating equipment are also considered part of the structure.
- Paved parking areas - including electric lines, lighting, connections, outlets, etc., from the power source or meter connection.
- Sidewalks that are a part of a system serving more than one building or activity.
- Fencing, including gates and fittings built as one integral unit.

b. Unit of Capitalization. The decision as to whether to capitalize or expense an asset is made based on all the costs that go in to creating it, regardless of whether those costs are incurred under one or many projects/tasks, and not at the individual invoice or charge level.

**Example:** *The FAA incurred the following costs in connection with the construction of a new remote communications outlet (RCO):*

<i>Antenna Tower – materiel costs</i>	<i>\$300,000</i>
<i>Antenna Tower – installation labor costs</i>	<i>\$150,000</i>
<i>Building</i>	<i>\$ 40,000</i>
<i>Fencing around perimeter of property – materiel cost</i>	<i>\$ 15,000</i>
<i>Fencing around perimeter of property – installation costs</i>	<i>\$ 12,000</i>
<i>ABC Construction Company: Access road to Site</i>	<i>\$ 20,000</i>
<i>ABC Construction Company: Construct Drainage system</i>	<i><u>\$ 34,000</u></i>
<i>Total project</i>	<i>\$571,000</i>

*In this example, 5 distinct assets were created: a building, a drainage system, an antenna, a fence, and an access road. The financial and property management treatment of these assets is as follows:*

*The building would be capitalized as a separate record - a building. The FA module will post GL account # 17306000, “Buildings, Improvements, Renovations,” in the amount of \$40,000.*

*The drainage system would be capitalized as a Land Improvement. The FA module will post GL account # 17126000, “Land Improvements,” in the amount of \$34,000.*

*The antenna tower would be capitalized as Other Structures. The FA module will post GL account # 17406000, “Other Structures and Facilities,” in the amount of \$450,000.*

*The fence would be capitalized as an Other Structure. The FA module will post GL account # 17406000, “Other Structures and Facilities,” in the amount of \$27,000.*

*The access road, would be expensed as it does not meet one of the capitalization criteria. The FA module will post GL account # 61006600, “Operating Expense,” in the amount of \$20,000.*

*While the access road does not meet the criteria as a capital asset, it is nevertheless an “accountable” asset. As such, it will be recorded in the REMS system.*

**3-7. ASSETS UNDER CAPITAL LEASE.** The following guidance applies to both real and personal property. There are two basic classifications of leases, operating and capital.

**General Ledger Account 18106000 - Assets Under Capital Lease**

a. Operating leases. Operating lease payments are treated as charges to operating expenses and are not capitalized as an asset. Operating leases result in an expense to the annual accounting period.

b. Capital leases. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. A capital lease must capitalize upfront, the amount that equals the present value of the lease payments or the fair market value of the asset, whichever is less. General Accepted Accounting Principles (FAS-13) and FASAB No. 6 delineate four criteria for making the determination as to whether or not a lease will be treated as a capital lease. If a lease meets one or more of the following four criteria, it is classified as a capital lease:

1. By the end of the lease term, ownership of the leased property is transferred to the lessee.
2. The lease contains a bargain purchase price option.
3. The lease term is substantially (75% or more) equal to the estimated useful life of the leased property.<sup>1</sup>
4. At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90% or more of the fair value of the leased property.<sup>1</sup>

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<sup>1</sup> This criterion is not applicable when the beginning of the lease terms falls within the last 25% of the total estimated economic life of the lease property.

c. FAA has an obligation to capture all leases in DELPHI, both operating and capital. The process begins with a project set up for the lease. Next, a purchase order is established in PRISM, the FAA's purchasing system. A payment schedule is established in the FA module and a leased asset is established. The FA module will send a lease record to REMS. A leased payment batch will be created in the DELPHI Payables module on the 5<sup>th</sup> day of each month. The FA and Payables training courses contain detail screens and steps in the lease process.

1. The FA module will test for the type of lease (capital or operating) based upon the four capital lease criteria. DELPHI will make this entry, after completion of the lease details in the FA module.

2. The accounting office records the lease details, creates payments schedules, and attaches payment information and the lease number to the asset record.

3. The FA module will capitalize and depreciate leased assets that meet the capitalization criteria. A capital lease by definition is recorded as an asset with a corresponding credit to Capital Lease Liability, GL account series 29400200 through 29409999 (refer to Appendix B, General Ledger Accounts for Property, Plant and Equipment).

### **3-8. LEASEHOLD IMPROVEMENTS.**

<b>General Ledger Account 18206000 - Leasehold Improvements</b>
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a. Leased assets usually provide for the opportunity for lessees to invest in improvements to the leased assets to enhance their usefulness. These investments are referred to as leasehold improvements. They are established in a separate account at cost and are amortized over the shorter of the life of the improvement or the length of the lease.

b. Because improvements will revert to the lessor at the end of the lease term, the period of depreciation should not exceed the term of the lease. If the lease has a specific clause that allows for renewal, then assume that the intent is to renew, and calculate the life of the improvement over the lease period with renewals. For example, if a building lease has an initial 10-year term and has a renewal option for an additional 10-year term, then use 20 years as the useful life of the leasehold improvement.

**3-9. COMMON COSTS.** Refer to paragraph 4-7 for information relating to the collection and distribution of common costs.

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